

**DEPARTMENT OF INSURANCE
STATE OF UTAH**

REPORT OF EXAMINATION

of the

PROFESSIONAL UNDERWRITERS LIABILITY INSURANCE COMPANY

as of

December 31, 2001

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Napa, California
June 20, 2003

The Honorable Merwin U. Stewart
Insurance Commissioner
State of Utah Insurance Department
3110 State Office Building
Salt Lake City, Utah 84114

Sir,

Pursuant to your instructions and in conformity with the provisions of Utah Code Annotated (U.C.A.) and Utah Administrative Code (U.A.C.), a full scope examination has been made of the administrative affairs, books, records, and financial condition of

Professional Underwriters Liability Insurance Company

of
Napa, California 94559

a casualty insurance company, hereinafter referred to as the "Company", as of December 31, 2001.

The following report of examination is respectfully submitted.

Scope of Examination

Period Covered by Examination

This examination covered the period January 1, 1998 through December 31, 2001, and included a review of material transactions and/or significant events occurring subsequent to the examination date as well as those noted during the course of this examination.

Examination Procedure Employed

The examination was conducted to determine compliance with generally accepted regulatory standards and procedures in conformity with Utah Code Annotated (U.C.A.) and Utah Administrative Code (U.A.C.), and in accordance with the National Association of Insurance Commissioners (NAIC) accounting guidelines and procedures.

The Company retained the services of a certified public accounting (CPA) firm to audit its records for the entire period under examination. The CPA audit reports generated during this period, as well as various work papers, certified confirmations, and other supporting documentation for the financial statements as of December 31, 2001, were made available for examination purposes, and were utilized by the examination on a limited basis, where appropriate, as supplemental support.

Status of Prior Examination Findings

The prior examination was conducted by the Utah Department of Insurance, and covered the period from January 1, 1995 through December 31, 1997. The prior examination report contained a material adjustment to the loss and loss expense reserves, a re-classification of a reinsurance liability, and a comment concerning non-compliance with U.C.A. Section 31A-2-204(8) of the Utah Insurance Code.

The items and issues addressed during the prior examination were reviewed during the course of the current examination. It was concluded that the Company had taken appropriate action on these matters and had implemented sufficient corrective measures as of December 31, 2001.

History

General

The Company was incorporated on September 19, 1989 as a stock insurance company, under the provisions of U.C.A. Section 31. The Company's articles of incorporation stated that the purpose for which the corporation is organized is to "insure all risks." Certificates of authority issued the Company permit the transaction of disability, property, surety, liability, marine and transport, workers compensation, vehicle liability and professional liability lines of business in Utah, and liability business in California. The articles of incorporation and bylaws were amended effective February 15, 2001, to authorize the issuance of 300,000 additional shares of common stock at a par value of \$10.00 per share.

Capital Stock

Effective February 15, 2001, the articles of incorporation and bylaws were amended to authorize and issue 500,000 shares of common stock at par value of \$10.00 per share with an aggregate value of \$5,000,000. As of December 31, 2001, all shares were issued and outstanding. The Company is wholly owned and controlled by The Doctors Company (TDC), a California corporation.

Dividends to Stockholders

No dividends were paid to the stockholder during the period under examination.

Management

The Company's articles of incorporation and bylaws require that the Company be managed by a board of directors consisting of seven members. The bylaws also provided that the directors will be elected at the annual meeting of shareholders, and each of those elected will serve until the next succeeding annual meeting or until a successor has been elected. The following persons were serving as directors of the Company at December 31, 2001:

<u>Name & Residence</u>	<u>Principal Business Affiliation</u>
Richard E. Anderson, M.D. Delmar, California	Chairman of the Board of Governors The Doctors' Company
Charles A. O'Brien Danville, California	Governor The Doctors' Company
Jerrald R. Goldman, M.D. Lafayette, California	Governor The Doctors' Company
Mark Gorney, M.D. Napa, California	Governor The Doctors' Company
Robert Blair Sheppard Carmel, California	Governor The Doctors' Company
David M. Charles, M.D. Denver, Colorado	Governor The Doctors' Company
Manuel S. Puebla Somis, California	Governor The Doctors' Company

As of December 31, 2001, the following persons were serving as duly elected or appointed officers of the Company:

Manuel S. Puebla	President and Vice President
Michael Jacob	Secretary
Douglas Will	Treasurer

The Company has filed biographical affidavits on each of the officers and directors with the Utah Department of Insurance.

Committees

The Doctors' Company, in its capacity as the ultimate controlling person and 100% owner of the Company's stock, has appointed several committees, some of which are involved in the business affairs and matters of the Company to the extent deemed necessary and appropriate.

Included among these, is the Finance and Audit Committee, which is generally considered as the "acting audit committee" on the Company's behalf, and the Investment Committee. Because of this relationship, the Company was determined to be exempt from the requirement of an audit committee pursuant to U.C.A. 31A-5-412(2), due to the fact that the lone shareholder was represented on the board of directors pursuant to U.C.A. 31A-5-407(4). No committees have been appointed which serve exclusively for the interests of the Company.

The following individuals were serving as members on the Finance and Audit Committee and the Investment Committee as of December 31, 2001:

Finance and Audit Committee

Robert B. Sheppard
Richard E. Anderson
John A. Bohn
John A. McRae
Manuel S. Puebla
Michael Yacob

Investment Committee

David M. Charles
Richard E. Anderson
John A. Bohn
John A. McRae
Charles A. O'Brien
Manuel S. Puebla
Robert B. Sheppard
Michael Yacob

Conflict of Interest

The Company does have a formal written conflict of interest policy. This policy requires the directors, officers, and key staff members of the Company to file an annual disclosure statement which requests a declaration and disclosure of any material interest or affiliation which is in conflict or is likely to conflict with the individual's official duties at the Company.

A review of forms signed and filed during the examination period disclosed no material interests or affiliations which could be construed as a conflict or potential conflict of interest.

Corporate Records

The minutes of meetings of the board of directors and the finance and audit committees were reviewed during the course of the examination. The meetings were held on a regular quarterly basis, and adequately documented the Company's business activities throughout the examination period. The minutes disclosed that the previous examination report, as of December 31, 1997, was reviewed by the directors of the Company.

As previously noted, resolutions were adopted on February 15, 2001 to amend the articles of incorporation and bylaws for issue of an additional 300,000 shares of common stock at \$10 par value. The records disclosed that the amendments had been filed with the Utah Insurance Department pursuant to U.C.A. Section 31A-5-203 (4), and approved by the Commissioner pursuant to U.C.A. Section 31A-5-219.

Affiliated Companies

Holding Company System

The Company is a member of a holding company system, pursuant to the provisions of U.C.A. 31A-16-105, and as previously noted, is owned 100% by The Doctors' Company.(TDC). The Company has no ownership or partial ownership of any of the subsidiaries of TDC, or any non-related entity. In addition to the Company, TDC exercises 100% ownership of nine other companies, some of which are involved with the operations of the Company pursuant to provisions of certain administrative and service agreements. The TDCs Company holding company system is identified immediately below.

The Doctors Company

- Bernard Warschaw Insurance Sales Agency
- The Doctors Management Company
- The Doctors Life Insurance Company (California domiciled)
- TDC UK (United Kingdom domiciled)
- The Doctors Company Insurance Services (Subsidiaries include: TDCIS Equities Company; The Doctors Insurance Services, Inc.; The Doctors Company Insurance Services of Wyoming)
- Professional Underwriters Liability Insurance Company (Utah domiciled)
- Underwriter for the Professions Insurance Company (Colorado domiciled)

Agreements with Affiliates

As of December 31, 2001, the Company was party to a management agreement with The Doctors' Management Company, (TDMC), an agency agreement with Bernard Warschaw Insurance Sales Agency, Inc., (Warschaw), a consolidated federal tax filing agreement with TDC, and a reinsurance agreement with TDC. With the exception of the reinsurance agreement (described under a subsequent caption) the agreements are summarized as follows:

1. Management Agreement (TDMC): (effective September 10, 1993)

Under the terms of this agreement, TDMC, agrees to provide the Company with personnel, office facilities, equipment and supplies, accounting services and financial reporting, and all management and supervisory functions as necessary for the operation of the Company, including underwriting, policy issuance/cancellation and premium collection.

Provision is made for the Company to reimburse TDMC, on a monthly basis, for the actual cost of all the services and facilities provided. The initial term of the agreement was for a one-year period, with automatic one-year renewals. The agreement may be terminated by either party, upon submission of a written notice to cancel at least ninety days prior to the annual renewal date.

A review of inter-company accounts and ledger entries posted in conjunction with this agreement disclosed that the cost allocations for the services provided and the expenses related thereto were allocated on a percentage of direct premiums written basis among the Company, TDC, and UFPT.

It is recommended that Section IV of this agreement ("TDMC's Compensation") be amended to provide a more accurate description of the nature of the allocations and the applicable percentages actually used to determine the Company's liability under the contract.

2. Agency Agreement (Warschaw): (effective September 1993)

The Company appointed Warschaw as its agent and producer for purposes of solicitation of applications for, and the production/servicing of insurance contracts issued by the Company in all

states where the Company wrote medical professional liability insurance. Subject to the approval of the Company, Warschaw may appoint and contract with sub-producers, to solicit or carry out any of the duties and services as prescribed in the agreement. Warschaw provided the Company with a monthly accounting of all business produced, and agreed to maintain an accounting system which was sufficient to properly reflect all transactions in accordance with generally accepted accounting principles.

Warschaw was compensated with a 15 percent commission of the gross net written premium for each policy as shown on a monthly bordereau provided to the Company. The agreement included a termination provision which required a 120 day written notice by either party to the other.

Federal Income Tax Filing (TDC): (effective 1992)

In accordance with an agreement between TDC and all its subsidiaries, the Company had filed consolidated federal income tax returns commencing with the calendar year 1992. The consolidated taxes reported were allocated to the members of the holding company group using the separate return basis.

Fidelity Bond and Other Insurance

As of December 31, 2001, the minimum fidelity bond coverage recommended by the NAIC was \$400,000 to \$450,000 for the Company's exposure index. The Company was a named insured on a fidelity bond, which included TDC and all subsidiaries, with a coverage limit of \$3,000,000, and a deductible amount of \$75,000, which substantially exceeded the recommended coverage.

The Company was also a named insured on policies providing for directors and officers liability, and errors and omissions coverage.

Pension, Stock Ownership, and Insurance Plans

The Company had no pension, stock ownership or insurance plans. All employee salaries and benefits were administered by TDMC, under the provisions of a management agreement, which was summarized in a previous section of this report.

Statutory Deposits

Statutory deposits as required by various state insurance departments as of December 31, 2001, are listed in the following schedule:

<u>State</u>	<u>Type</u>	<u>Par Value</u>	<u>Market Value</u>
Arkansas Insurance Department	Bonds	\$ 275,000	\$ 295,883
Delaware Insurance Department	Bonds	500,000	670,938
Louisiana Insurance Department	Bonds	125,000	117,070
Massachusetts Insurance Department	Bonds	700,000	733,688
New Mexico Insurance Department	Bonds	125,000	130,938
Nevada Insurance Department	Bonds	300,000	308,273
Oklahoma Insurance Department	Bonds	125,000	117,070
South Carolina Insurance Department	Bonds	150,000	161,391
Utah Insurance Department	Bonds	<u>2,600,000</u>	<u>2,894,407</u>
Totals		<u>\$4,900,000</u>	<u>\$5,429,658</u>

The deposits with the Utah Insurance Department met the requirements of U.C.A. Section 31A-4-105, and Subsection 31A-5-211(2), and were held for the benefit of all policyholders. The deposits held by the other states listed above were for the benefit of policyholders, claimants, and/or creditors of the Company in that jurisdiction only.

Insurance Products and Related Practices

Policy Forms and Underwriting

The Company specialized in writing high risk, nonstandard medical professional liability coverage. Coverage was written on a claims-made basis, with some prior act and tail coverage. Policies were issued for a maximum limit of \$1,000,000 per claim, with a \$3,000,000 aggregate limit per policy per year. The Company's net retained loss liability on all policies is 10% per loss and related expenses, with a maximum exposure of \$100,000 per loss, and \$300,000 annual aggregate, due to facultative placements and a 90% quota share reinsurance agreement with TDC.

Territory and Plan of Operation

The Company was licensed and authorized to transact insurance business in the States of Utah and California as of December 31, 2001. The certificates of authority permit the transaction of disability, property, surety, liability, marine and transport, workers compensation, vehicle liability and professional liability lines of business in Utah, and liability business in California. The Company is primarily engaged in underwriting nonstandard medical professional liability coverage as noted previously.

The Company was approved as a surplus lines carrier in 33 states as of December 31, 2001. A review of Schedule "T" disclosed that premiums were written in 11 additional states, plus the District of Columbia during 2001. The Company received approval as a surplus lines carrier in two additional states during 2002.

Bernard Warschaw Insurance Sales Agency, Inc., was the managing general agent of the Company, and the major producer of premium. Warschaw also conducted the marketing and sales functions, as noted under a previous caption entitled "Agreements with Affiliates." This agency served as general agent to approximately 700 brokers located throughout the United States. Two additional agencies, David Wood Insurance Agency, and Pacific Professional Insurance Services were utilized by the Company during the period under examination, and produced approximately 14% of the total written premium during 2001.

Advertising and Sales Material

A review of advertising and marketing promotional materials utilized by the Company indicated no misleading statements, or comments which would be considered inappropriate in conjunction with the policies and products offered by the Company.

Treatment of Policyholders

During the course of the examination, a review of open and closed claims was performed in conjunction with audit procedures related to year-end claims reserves established by the Company at December 31, 2001. It was concluded that the Company's processing and handling of claims was performed within a reasonable amount of time, and that the settlements reached were

consistent with the facts and circumstances related thereto. A review of the Company's history recorded on the COSMOS software system used by the Utah Insurance Department indicated no complaints were made during the examination period.

Reinsurance

Assumed

As of December 31, 2001, the Company was party to one assumption agreement, which was effective July 1, 2000. Under the terms of this agreement, the ceding Company, Texas Medical Insurance Company (TMIC) ceded a 75% quota share of its net liabilities on physicians professional liability policies which were issued on or after the effective date. TMIC retains 25% of each and every loss, and the Company accepts a 75% quota share not to exceed 75% of \$1,000,000 each loss, each policy, each insured, and up to \$3,000,000 each insured, in the aggregate each policy.

Ceded

The net retained loss liability on all policies, after facultative placements and excess of loss cessions, was reinsured by The Doctors Company under a 90% quota share agreement as of December 31, 2001. This agreement was effective July 1, 2001 through June 30, 2002, and applied to all books of business; substandard, standard physicians, and hospital coverage.

The Company's net policy limit was 10% per loss and related expenses, and annual aggregate. The maximum exposure was \$100,000 on any one loss, and \$300,000 annual aggregate. The Company is protected 100% against any extra contractual obligations or losses in excess of policy limits.

This agreement was preceded by several others executed during the examination period, all with 90% quota share percentages. The agreements were generally written on an annual basis with underwriting year dates running from July 1st through June 30th of the following year.

During the two year period July 1, 1998 through June 30, 2000, the Company ceded a 90% quota share of the substandard business through Aon Re Inc., a reinsurance broker, which placed various percentages of the business with participating domestic and non-domestic reinsurers, including Underwriters At Lloyds. Participating percentages generally ranged from 0.85% to 15% per reinsuring entity. From July 1, 2000 through June 30, 2001, the Company retained 50% of the substandard business and retro-ceded the remaining 50% to participating reinsurers through brokers.

During 1998, the Company began facultative placements with various reinsurers on large hospital facilities with multi-doctor staffs. Facultative reinsurance is generally placed on policies which exceed a million dollar retention, although a lower threshold may be considered depending on the circumstances.

Accounts and Records

The Company's accounting records were maintained on TDMC's electronic data processing system, under the terms of management agreement noted in a previous section of this report. The accounting system included a general ledger, various journals and subsidiary records, which were produced through a centralized computer and a number of terminals and personal computers.

The Company's summary ledger balances and adjustments were reconciled and traced into the year 2001 annual statement balance sheet. Additional reconciliations were performed in conjunction with annual statement changes between the years 2000, and 2001, and traced into major statement exhibits to the extent deemed necessary for the respective years.

The Company retained an independent certified public accounting firm to audit its balance sheets as of December 31, 1998, 1999, 2000, and 2001, and the related statements of income, equity and cash flow for the years then ended. Certified audit reports, accompanying financial statements, and supplemental information for all of the above four years were made available to the examination, including the CPA's work papers for the year 2001. The work papers, certified confirmations, and other supporting documentation for the financial statements as of December 31, 2001 were made available for examination purposes and were utilized by the examination on a limited basis as supplemental support.

The Company's aggregate loss and loss adjustment expense reserves were reviewed and opined on by a major independent actuarial firm for all of the four years under examination. The actuarial reports and opinions rendered thereon were also made available for examination purposes.

Prior to the commencement of the examination on site, various questionnaires were mailed to the Company for preliminary planning purposes. These included requests for information regarding evaluation of risk and control, related to major accounts and areas of operations, procedural narratives, and an overview of key personnel involved. The questionnaires were not completed until the examination was well underway. This delay minimized their value for planning purposes, and resulted in additional time and delay in completion of the planning file for review and approval by the Utah Insurance Department. As this is an important phase of the examination, it is recommended that the Company give these questionnaires priority in future examinations, and ensure that they are completed prior to the beginning of on site field work.

Financial Statements

The financial section of this report contains the following statements and exhibits:

Balance Sheet as of December 31, 2001

Summary of Operations for the Year ended December 31, 2001.

Reconciliation of Surplus Accounts, December 31, 1998 to December 31, 2001

Professional Underwriters Liability Insurance Company
Balance Sheet
As of December 31, 2001

Net Admitted Assets

Bonds	\$30,153,482	
Cash	1,277,266	(Note 1)
Short-term investments	2,745,321	(Note 1)
Receivable for securities	21,875	
Agents balances or uncollected premium	7,574,840	
Reinsurance recoverables on loss and loss adjustment expense payments	4,928,864	(Note 2)
Federal income tax recoverable	201,049	
Investment income due and accrued	424,515	
Receivable from parent, subsidiaries and affiliates	406,927	
Miscellaneous	<u>10,872</u>	
Total assets	<u>\$47,745,011</u>	

Liabilities, Surplus and Other Funds

Losses	\$ 2,585,632	(Note 3)
Loss adjustment expenses	1,363,368	(Note 3)
Other expenses	18,806	
Taxes, licenses and fees	142,213	
Federal income taxes	41,586	
Unearned premiums	2,340,121	
Ceded reinsurance premiums payable	2,858,560	
Amounts withheld or retained for account of others	15,143	
Provision for reinsurance	802,570	
Payable to parent, subsidiaries and affiliates	<u>928,849</u>	
Total liabilities	<u>\$11,096,848</u>	
Common capital stock	\$ 5,000,000	
Gross paid in and contributed surplus	16,500,000	
Unassigned funds (surplus)	<u>15,148,163</u>	(Note 4)
Surplus	<u>\$36,648,163</u>	
Total liabilities and surplus	<u>\$47,745,011</u>	

Professional Underwriters Liability Insurance Company
Summary of Operations
For the Year ended December 31, 2001

Underwriting Income

Premiums earned	\$ 3,182,440
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Deductions

Losses incurred	801,226
Loss expenses incurred	1,081,627
Other underwriting expenses incurred	<u>5,216,300</u>
Total underwriting deductions	<u>7,099,153</u>
Net underwriting gain or (loss)	<u>(3,916,713)</u>

Investment Income

Net investment income earned	2,356,156
Net realized capital gains or losses	<u>479,970</u>
Net investment gain or loss	<u>2,836,126</u>
Net income before federal income taxes	(1,080,587)
Federal income taxes incurred	<u>9,958</u>
Net Income	<u>\$(1,090,545)</u>

Professional Underwriters Liability Insurance Company
Reconciliation of Surplus Accounts
December 31, 1998 to December 31, 2001

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Surplus December 31, previous year	<u>\$28,444,061</u>	<u>\$32,756,959</u>	<u>\$33,932,816</u>	<u>\$35,279,372</u>
Net Income	3,636,891	1,450,018	1,353,570	(1,090,545)
Net unrealized capital gains or (losses)	(45,487)	(97,169)	88,564	(239,363)
Change in net deferred income tax				150,864
Change in non-admitted assets			(20,000)	883
Change in provision for reinsurance	721,494	(176,992)	(75,578)	(550,000)
Cumulative effect of changes in accounting practices				96,951
Change in paid in capital	<u> </u>	<u> </u>	<u> </u>	<u>3,000,000</u>
Net change in capital and surplus	<u>4,312,898</u>	<u>1,175,857</u>	<u>1,346,556</u>	<u>1,368,791</u>
Capital and surplus account, December 31	<u>\$32,756,959</u>	<u>\$33,932,816</u>	<u>\$35,279,372</u>	<u>\$36,648,163</u>

Notes to Financial Statements

(Note 1) Cash and Short-term Investments \$ 4,022,587

The Company's 2001 Schedule "E" originally included a short-term U.S. Treasury Bill in the amount of \$1,999,200, which was re-classified from Cash to Short-term investments in accordance with NAIC accounting guidelines. As the two aforementioned accounts were decreased and increased respectively by the same amount, there was no effect on the Company surplus.

(Note 2) Reinsurance recoverables on loss and LAE payments \$ 4,928,864

Examination findings disclosed an unrecorded recoverable from a facultative reinsurer totaling \$652,888. Of this amount, \$587,599 (90%) was due to TDC under the terms of the reinsurance agreement. This amount was offset against a receivable component of \$414,696 due from TDC included in the amount originally reported in the annual statement, resulting in a net increase to this asset of \$65,289.

(Note 3) Losses \$ 2,585,632
Loss Adjustment Expenses \$ 1,363,368

As a result of an actuarial review performed by Taylor-Walker & Associates (TW&A), the loss reserves and loss adjustment expense reserves as originally reported by the Company, were increased by the amounts of \$722,553 and \$380,919 respectively. TW&A was retained by the Utah Department of Insurance to perform the actuarial phase of the examination.

The following recommendations were made by TW&A pursuant to the firm's actuarial review and findings:

1. The Company and the opining actuary should carefully review the reasonableness of booked reserves for each program.
2. The Company should correctly account for reinsurance in accordance with the applicable reinsurance contracts.
3. In consideration of the adverse experience related to certain blocks of business, the Company should review the premium deficiency reserve requirements when preparing future annual statements.

(Note 4) Surplus

\$ 36,648,163

The Company's surplus was determined to be \$1,038,183 less than reported. The following schedule identifies examination changes:

<u>Account/Item Description</u>	<u>Per Company</u>	<u>Per Examination</u>	<u>Change in Surplus</u>	<u>Notes</u>
Reinsurance recoverables on loss and loss adjustment expenses	4,863,575	4,928,864	65,289	(2)
Losses	1,863,079	2,585,632	(722,553)	(3)
Loss adjustment expenses	<u>982,449</u>	<u>1,363,368</u>	<u>(380,919)</u>	(3)
Total net adjustments			(1,038,183)	
Capital and Surplus per Company			<u>37,686,346</u>	
Capital and Surplus per Examination			<u>\$36,648,163</u>	

U.C.A. Subsection 31A-5-211 (2)(f) requires the Company to maintain minimum capital in the amount of \$2,000,000. As of December 31, 2001, the Company's total adjusted capital was \$36,648,163. Its authorized control level risk based capital requirement, as reported in the 2001 annual statement, was \$2,195,287. The adjustments made per examination findings would not have a significant impact on the Company's authorized control level risk based capital requirement.

Summary Comments and Recommendations

Items of significance noted during the course of the examination are summarized as follows:

Capital and Surplus: As of December 31, 2001, the Company's total adjusted capital was determined to be \$36,648,163 for examination purposes. Its authorized control level risk based capital requirement, as reported in the 2001 annual statement, was \$2,195,287. The adjustments made per examination findings would not have a significant impact on the Company's authorized risk based capital requirement. (See "**Notes to Financial Statements**")

Examination Planning: Information to be used for examination planning purposes was not provided by the Company on a timely basis in order to facilitate the planning process. (See "**Accounts and Records**")

Losses and Loss Adjustment Expenses: Recommendations for improvement of Company reserving procedures were made by the actuarial firm retained for examination purposes. (See "**Notes to Financial Statements**")

Conclusion

The courteous assistance and cooperation extended by the officers, staff members, and other representatives of the Company during the course of this examination is acknowledged and appreciated.

R. Glenn Taylor, FCAS, MAAA and Randall D. Ross, Actuarial Analyst, of Taylor-Walker & Associates, Inc., performed the actuarial phase of the examination.

Respectfully submitted,

Jim Beckenhauer, CFE
Examiner-in-Charge
Utah Insurance Department